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No. 96-1632

In The

Supreme Court of the United States

October Term, 1996

PSI REPAIR SERVICES, INC.,

Petitioner,

vs.

HONEYWELL INC.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED FOR REVIEW

Whether an antitrust plaintiff can maintain claims patterned after *Eastman Kodak Co. v. Image Technical Servs., Inc.* where the defendant's restrictive parts policy has been unchanged and disclosed to customers at the time of the equipment purchase, where the defendant has otherwise sought to reduce information costs associated with that policy, and where the manufacturer does not have market power in the equipment market.

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Honeywell Inc. ("Honeywell") requests that the Court deny the Petition of PSI Repair Services, Inc. ("PSI") for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit in the matter of *PSI Repair Servs., Inc. v. Honeywell Inc.*, reported at 104 F.3d 811 (6th Cir. 1997) and reproduced at Appendix A to the Petition ("Pet. App. A").

STATEMENT OF THE CASE

A. Introduction.

PSI's Petition represents the culmination of its efforts to force this case into the mold of *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992) ("*Kodak*"), notwithstanding a distinctly different, and fully developed, record. After approximately a year and one-half of discovery, the production of hundreds of thousands of pages of documents, and the depositions of 30 fact witnesses and five expert witnesses, in addition to a detailed evidentiary hearing, both the district court and the Sixth Circuit Court of Appeals concluded that the facts of this case were distinctly dissimilar to those of *Kodak*, warranting a different result than that reached in *Kodak*.

PSI has not resigned itself to the differences between the records in these two cases, and has attempted to characterize the Sixth Circuit's decision as contrary to *Kodak*. In so doing, PSI misinterprets *Kodak* as an ironclad rule that the mere existence of information or switching costs necessarily leads to a conclusion of market power in

a derivative market for replacement parts for durable equipment. This interpretation, however, is contrary to *Kodak*'s admonition against legal presumptions and fails to address the Court's recognition that a more fully developed record might have sustained Kodak's theory. *Kodak*, 504 U.S. at 486 ("In the end, of course, Kodak's arguments may prove to be correct . . . [b]ut we cannot reach this conclusion on a record this sparse"); *see* 10 Phillip E. Areeda, et al., *Antitrust Law* § 1740g, at 173 (1996) (in *Kodak*, the Court "held only that summary judgment was premature" given the "sparse" record). In this case, the district court and the Sixth Circuit had a fully developed record upon which to evaluate PSI's claim that Honeywell wielded market power. Both courts correctly found that claim wanting. Accordingly, this matter does not merit review by this Court.

B. Allegations and Proceedings Below.

PSI challenges Honeywell's policy of not selling the individual electronic components (microprocessors, resistors, capacitors, etc.) that reside upon Honeywell's computer circuit boards. These circuit boards are themselves parts used in the industrial automation control equipment that Honeywell sells to its customers for monitoring and controlling the industrial processes in refineries and factories. While PSI has sought to analogize this case to *Kodak*, it has never explained why this policy constitutes a tie. Accordingly, at the close of discovery, Honeywell moved for summary judgment on multiple grounds, all founded on the contention that PSI's claims were inherently flawed and economically senseless.

The district court granted summary judgment in Honeywell's favor, finding that PSI's claim did not involve two distinct products. The Sixth Circuit Court of Appeals disagreed with the district court's decision, but concluded that separate grounds existed for affirming the judgment. Specifically, the court found that there was no evidence that Honeywell took advantage of alleged market imperfections by changing its after-market policy or by otherwise misleading customers about that policy. *PSI Repair Servs., Inc. v. Honeywell Inc.*, 104 F.3d 811, 820-21; Pet. App. A. 25-26 (6th Cir. 1997). Absent such evidence of predatory conduct that would create a "lock-in" effect in the alleged after-markets, the Sixth Circuit held that the relevant market consisted of Honeywell's industrial automation control equipment, rather than the after-market for parts. *Id.* As Honeywell has no market power in the primary equipment market, the court affirmed summary judgment in Honeywell's favor on both of PSI's claims under Sections 1 and 2 of the Sherman Act. *Id.* at 821-22; Pet. App. A-26-29.

C. Correction of Misstatements in the Petition.

The record before the district court and the court of appeals was both extensive and detailed as to the commercial realities faced by the industry in which Honeywell competes. Both courts relied upon particular facts in this extensive record which were not present in *Kodak*. PSI has ignored and/or mischaracterized several of these facts in its Petition.

It is undisputed that Honeywell does not possess market power in the market for industrial automation

control equipment, the primary equipment market. Competition is vigorous within this market, and the customers in this market are large, technically-sophisticated companies that engage in lengthy evaluations and detailed analyses of this expensive[1] equipment prior to the purchase. As a result of this process, Honeywell's customers are aware, prior to purchase, of Honeywell's policy of not selling electronic components. C.A. App. at 270-72, 508-10, 523-25, 973-79. The record is undisputed that Honeywell has not changed its components policy over the years.

Although it is difficult to predict with complete accuracy the total cost of maintaining these complex systems throughout their useful life, Honeywell assists its customers in assessing such life-cycle costs at the time of sale, including, but not limited to: providing information regarding spare part failure rates; offering service programs to minimize life-cycle costs; and discussing redundancy options/recommended spare parts in the case of system failure. *Id.* Honeywell's efforts thus minimize the information costs faced by end-users of its equipment. *PSI Repair Servs., Inc.*, 104 F.3d at 820-21; Pet. App. A-25. In fact, the majority of Honeywell's customers for new systems come from its current customer base; that is, repeat customers who are building new facilities. These customers have already had long term experience with, and significant understanding of, Honeywell's equipment at the time of purchase. C.A. App. 524-26.

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[1] The median price for a TDC 3000 system is $600,000 to $800,000, plus substantial installation costs. C.A. App. at 274-75.

The record is barren of any deposition testimony or sworn affidavit from a Honeywell customer indicating dissatisfaction with Honeywell's policy or a desire to do business with PSI. Instead, PSI bases its claims of market foreclosure and forced consumption of Honeywell's services upon a survey undertaken by one of its experts. PSI admitted, however, that its survey does not reflect a demand for Honeywell's proprietary electronic components for its TDC systems, the primary item at issue in this dispute. C.A. App. at 453.

Moreover, contrary to PSI's assertions, there is no evidence of supracompetitive prices for Honeywell's replacement boards in the record before this Court. Rather, Honeywell prices its replacement circuit boards utilizing the same formula PSI uses for pricing its board repair services – 50 percent of the manufacturer's list price. C.A. App. at 306, 526, 818-20, 856-57. Accordingly, not only are Honeywell's pricing practices competitive, but also those practices are, by definition, linked to the primary equipment market. Furthermore, Honeywell charges the same price to all of its customers for replacement boards; there is no evidence of price discrimination among or between any subclasses of customers as to boards, equipment or any other alleged market.

REASONS FOR DENYING THE WRIT

I. THE COURT OF APPEALS' DECISION IS IN HARMONY WITH *KODAK*.

The Petition presently before the Court is based upon an overly broad and superficial interpretation of this Court's decision in *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992) ("*Kodak*"). In *Kodak*, this Court reversed the grant of summary judgment in favor of an antitrust defendant who had argued that, as a matter of law, it could not wield market power in an after-market for replacement parts for its micrographic equipment, as to do so would have adversely impacted its sales of the equipment itself, a primary market in which it held no market power. The defendant had moved for summary judgment before the plaintiff was afforded the opportunity to test whether any actual facts supported that theory. On the basis of this undeveloped record, the Court determined that Kodak's change in parts policy could have triggered certain information and switching costs relative to that policy to sever the link between the equipment market and the replacement parts market. *Kodak*, 504 U.S. at 473-77. Accordingly, the Court remanded the case to the trial court to allow the parties to develop a full record on these issues.

The instant case is factually distinct from *Kodak* with regard to a change in after-market parts policy. *Kodak* involved an unannounced and drastic change in a manufacturer's policy regarding replacement parts. In marked contrast, this case involves an unchanged and fully disclosed policy regarding the electronic components that

reside on Honeywell replacement parts. This factual distinction figured prominently in the Sixth Circuit's conclusion that *Kodak* did not prevent the entry of summary judgment in Honeywell's favor. *PSI Repair Servs., Inc.*, 104 F.3d at 820-21; Pet. App. A-25. ("The present dispute provides an ideal example of how our reading of *Kodak* can be applied in practice").

PSI challenges the legal significance of this distinction, contending that this Court's holding in *Kodak* was in no way based upon the competitive impact arising from *Kodak*'s change in policy. PSI's interpretation of *Kodak* is not supported by the text of that decision. The majority opinion itself characterized evidence of a change in policy as "crucial" to its holding. In responding to the dissent's observation that the Court would not have subjected Kodak to *per se* scrutiny had Kodak's customers understood from the outset that after-market support could be obtained only from Kodak, the majority implicitly accepted the legal premise of the dissent's hypothetical. The majority then distinguished the facts before the Court from that hypothetical on the grounds that Kodak's restrictive parts policy was unknown to its customers at the time of purchase:

> The only thing lacking to bring this case within the hypothetical case, states the dissent, is concrete evidence that the restrictive parts policy was . . . generally known. [Internal citation omitted]. But the dissent's only thing lacking *is the crucial thing lacking – evidence.*

Kodak, 504 U.S. at 477, n.24 (emphasis added). Indeed, a leading antitrust commentator has noted the importance of this change in policy to *Kodak*'s holding, citing this

very passage. 10 Phillip E. Areeda, et al., *Antitrust Law*, §§ 1740c and d at 150 and 157 (1996).

The majority's recognition that Kodak's change in policy was a crucial element to its decision is reflected in other parts of the opinion. For example, in discussing switching costs, the Court distinguished potential new customers from those customers "who already have purchased the equipment" when the policy was announced. The Court's discussion of these two classes of consumers reflects an obvious truism: potential new customers informed of the policy prior to purchase clearly do not face switching costs and thus do not face "lock in." *See Kodak*, 504 U.S. at 476. Thus, the Court instructed lower courts to examine, as evidence of market power, whether a defendant had engaged in price discrimination between existing customers who were locked in, and potential new customers, who were still able to take advantage of competition at the primary equipment level.

Finally, in *Kodak* this Court responded to Kodak's overall scheme to eliminate competition from the very market it had itself fostered prior to its change in policy. Customers of Kodak's micrographic equipment had purchased that equipment with the understanding that multiple service options were available, and independent service organizations had built their businesses on the understanding that they could obtain Kodak replacement parts. *Kodak*, 504 U.S. at 457-58. Kodak's original policy thus created and fostered competition; its change in policy was specifically calculated to destroy that competition. *Kodak*, 504 U.S. at 457-58, 476-77. Accordingly, Kodak's change in policy was the vehicle through which Kodak exercised its alleged market power; that change in

policy was an essential element of the Court's ruling denying summary judgment.

Although the absence of any change in Honeywell's policy was a significant factor in its analysis, the Sixth Circuit did not, contrary to PSI's contention, establish a rule of *per se* immunity for manufacturers based solely upon the absence of such a policy change. Rather, the court examined the entire circumstances surrounding Honeywell's parts policy and determined that Honeywell had not attempted to take advantage of any alleged market imperfections to sever the link between the equipment market and the parts market. In finding the equipment market to be the relevant market for antitrust inquiry, the court relied not only upon the absence of any change in policy, but additionally upon the totality of Honeywell's conduct with respect to the alleged market imperfections. *PSI Repair Servs., Inc.*, 104 F.3d at 820; Pet. App. A-24. ("We thus hold that an antitrust plaintiff cannot succeed on a *Kodak* type theory when the defendant has not changed its policy . . . *and the defendant has been otherwise forthcoming about its pricing structure and service policies*") (emphasis added).

The principle guiding Sixth Circuit's approach was whether Honeywell was guilty of taking advantage of, or coercing, its customers. The evil condemned by antitrust tying law is economic coercion; *i.e.*, forcing a customer to do something which it otherwise would not do. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12-14 (1984) ("*Jefferson Parish*"). Such economic coercion flows from the exercise of market power in the tying product market. Absent the exercise of such market power, there can be no coercion and thus no *per se* tying claim. *Id.*

While *Kodak* did address the relationship between economic coercion and market imperfections such as information and switching costs, it was not the first time this Court addressed this issue. As the Sixth Circuit noted, in *Jefferson Parish* this Court held that such "market imperfections" in the form of incomplete information do not, in and of themselves, generate the kind of market power that justifies *per se* condemnation. *PSI Repair Servs., Inc.*, 104 F.3d at 820; Pet. App. at A-23-24 (citing *Jefferson Parish*, 466 U.S. at 27). A consumer is not "forced" into a purchasing decision merely because he or she lacks perfect knowledge regarding the economic consequences of that decision. Rather, market power of the magnitude that merits *per se* condemnation requires proof of *something more* than just imperfect knowledge of the market. *Jefferson Parish*, 466 U.S. at 26-28. To hold otherwise would impose an economic paternalism upon sellers under the guise of antitrust policy.

The logical conclusion to be drawn from the combined teachings of *Jefferson Parish* and *Kodak* is that the required *something more* consists of conduct on the part of the defendant intended to take advantage of the market imperfections by way of the tying arrangement. The Sixth Circuit reached exactly this conclusion and then proceeded to examine the record for evidence of such conduct. *PSI Repair Servs., Inc.*, 104 F.3d at 820-21; Pet. App. A-24-25. It determined that the record was absolutely barren of any indication that Honeywell "took advantage" of any alleged market imperfections by changing or hiding its policy or by otherwise hindering an end-user's understanding of the long-term costs of that policy. *Id.* Rather, the Sixth Circuit found that Honeywell not only

disclosed its parts policy to the end-users of its equipment, but also made efforts to assist those users in evaluating the life-cycle costs of that equipment, thereby reducing the information costs. *Id.* Moreover, there was no evidence of price discrimination or supracompetitive prices. *Id.* Under these circumstances, Honeywell's customers were not forced or coerced to accept anything from Honeywell. Absent evidence of such coercion, summary judgment in Honeywell's favor was appropriate.

II. THERE IS NO CONFLICT AMONG THE CIRCUITS REGARDING THE APPLICATION OF *KODAK*.

Contrary to PSI's assertion, no conflict exists among the Circuit Courts of Appeal regarding the limitation of *Kodak* to situations where an antitrust defendant has changed its after-market policy or has otherwise taken advantage of market imperfections. Every circuit which has directly addressed this issue has ruled that some type of change or surprise is necessary in order to invoke *Kodak*. As noted in the Sixth Circuit's opinion in *PSI Repair Servs., Inc.*, both the First and Seventh Circuits have ruled that *Kodak*'s holding applies only when there has been a change in the defendant's after-market policy on which to base a lock-in theory. *See PSI Repair Servs., Inc.*, 104 F.3d at 819-20; Pet. App. A-22 (citing *Digital Equipment Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 763 (7th Cir. 1996) and *Lee v. Life Ins. Co. of North America*, 23 F.3d 14, 20 (1st Cir.), *cert. denied*, 513 U.S. 964 (1994). These opinions from the First and Seventh Circuits represent the only other instances where a Circuit Court of

Appeal has addressed this specific issue. The Sixth Circuit's opinion in *PSI Repair Servs., Inc.* is thus wholly consonant with current interpretation of *Kodak* among the circuits.

PSI contends that the Third and Fifth Circuits have adopted a conflicting interpretation of *Kodak*, citing *United Farmers Agents Ass'n, Inc. v. Farmers Ins. Exch.*, 89 F.3d 233 (5th Cir. 1996) ("*United Farmers Agents*"), and *Allen-Myland v. IBM*, 33 F.3d 194 (3d Cir.), *cert. denied*, 513 U.S. 1066 (1994) ("*Allen-Myland*"). PSI's reliance on these cases is absolutely misplaced in that neither case involved the issue presently before this Court. PSI has taken quotations from these decisions wholly out of context in its attempt to manufacture discord among the circuits where none exists. Neither the Third Circuit in *Allen-Myland* nor the Fifth Circuit in *United Farmers Agents* addressed whether *Kodak* applied in situations where the defendant has not changed its after-market policy and has otherwise informed customers about that policy.

In *United Farmers Agents*, the Fifth Circuit rejected plaintiffs' argument that a relevant derivative after-market even existed. The plaintiffs in *United Farmers Agents* were insurance agents alleging that the defendant insurance company's policy requiring agents to purchase a customized personal computer from the company in order to gain electronic access to policyholder information constituted an illegal tie. The plaintiffs alleged the relevant tying product market to be electronic access to policyholder information and the relevant tied product market to be customized personal computers. The Fifth Circuit concurred with the defendant's argument that the

relevant market consisted solely of the primary market, insurance sales, because defendant "sells insurance, not electronic access, not computers." 89 F.3d at 236. As the Fifth Circuit rejected the plaintiffs' contention that relevant derivative markets even existed, its opinion in *United Farmers Agents* cannot reasonably be read to conflict with those of the First, Sixth and Seventh Circuits.

Indeed, the Fifth Circuit explained *in dicta* that, even if it were to accept plaintiffs' definition of the relevant market, it would still reject plaintiffs' claim that the defendant wielded market power in the relevant market. *United Farmers Agents*, 89 F.3d at 237. After discussing *Kodak* at great length, the court observed that the agents could be divided into two classes: those that had contracted with the defendant prior to the implementation of the electronic access policy and those that had contracted with the defendant subsequent to that change in policy. As to those agents who joined after the change, the Court noted that there could be no *Kodak*-type allegations:

> Information and switching costs for Farmers agents hired after 1981 when FANS [the electronic policyholder service] was implemented were virtually nonexistent. The summary judgment record shows that Farmers openly required agents wishing to access FANS to do so only with computers purchased from Farmers. Any agent hired would have known of the two ways to obtain policy information and could have easily inquired about the cost of electronic access. . . . Agents would clearly have become aware of Farmers' policy long before they faced significant switching costs.

United Farmers Agents, 89 F.3d at 238. In dividing the plaintiffs into separate classes based upon whether they joined the defendant before or after the change in policy was announced, the Fifth Circuit implicitly recognized the limits of a *Kodak*-type theory to situations where the "customer" was not aware of the alleged tie prior to its "purchasing" decision. Accordingly, to the extent that the opinion in *United Farmers Agents* addressed the same issue now presented to this Court, it clearly concurs with the approach adopted by the First, Sixth and Seventh Circuits.

The opinion of the Third Circuit in the Court of Appeals in *Allen-Myland* similarly lacks any ruling regarding the applicable scope of *Kodak* in circumstances where there has been no change in the defendant's after-market policy. Indeed, *Allen-Myland* specifically involved a change in the defendant's after-market service policy that was implemented to take advantage of a new technology, known as a thermal conduction module, used in upgrading large-scale mainframe computers. 33 F.3d at 199. The plaintiff in *Allen-Myland* challenged the defendant's policy of bundling the parts and the labor necessary to perform mainframe upgrades. The plaintiff defined the tied product as the labor required to perform the upgrades, but advanced three alternative tying product markets: 1) large-scale mainframe computers; 2) the parts required to perform upgrades on IBM mainframe computers; and 3) the parts required to perform upgrades on all mainframe computers. 33 F.3d at 201.

The Third Circuit rejected the plaintiffs' alternative tying product markets which consisted of alleged after-markets in parts. 33 F.3d at 208. Rather, the Third Circuit

determined that the relevant product market consisted of large scale computers, in which the defendant held market power. 33 F.3d at 201-07. Given that the Third Circuit specifically rejected the proposed parts after-market in favor of a market consisting of the primary equipment, *Allen-Myland* offers absolutely no guidance on the issue before this Court.

Finally, PSI contends that a disagreement exists within the Sixth Circuit itself over this issue. PSI points to the Sixth Circuit's opinion in *Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660 (6th Cir. 1993) ("*Virtual*"), as evidence of its alleged internal conflict. Even if an intracircuit conflict existed, it would not warrant this Court's attention. There is, however, no inconsistency between the Sixth Circuit's decisions in *Virtual* and in this case. *Virtual* does not discuss whether the absence of a change or surprise would defeat a *Kodak* claim for the simple reason that such surprise was present in that case: the defendant did not disclose the alleged tie between the PDGS software upgrades and the hardware maintenance services until *after* the customer had made the substantial initial investment in PDGS software. *See* 957 F.2d 1318, 1322 (6th Cir.), *vacated*, 506 U.S. 910 (1992), *decision on remand*, 11 F.3d 660 (1993).

PSI has failed to demonstrate any discord or conflict among the circuits that would warrant this Court's issuance of the Writ. Rather, the consistent approach taken by those circuits addressing this issue has provided the guidance necessary to allow manufacturers and suppliers to engage in interstate commerce without any of the alleged dire consequences raised by PSI. Under these circumstances, there is no need for this Court's intervention.

CONCLUSION

For all the foregoing reasons, the writ of certiorari should be denied.

Respectfully submitted,

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